

No. 12,721

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

L. P. ST. CLAIR and ANNASTATIA ST. CLAIR,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal From the United States District Court for the
Southern District of California.

BRIEF FOR THE UNITED STATES.

THERON LAMAR CAUDLE,

Assistant Attorney General,

ELLIS N. SLACK,

HELEN GOODNER,

VIRGINIA H. ADAMS,

Special Assistants to the Attorney General.

Department of Justice Building,

Washington 25, D. C.,

ERNEST A. TOLIN,

United States Attorney.

E. H. MITCHELL,

EDWARD R. McHALE,

Assistant United States Attorneys.

600 Federal Building,

Los Angeles 12, California,

FILED

MAY 1 1951

RAUL H. O'BRIEN,

CLERK

TOPICAL INDEX

	PAGE
Opinion below	1
Jurisdiction	1
Question presented	2
Statutes and Regulations involved.....	2
Statement	2
Summary of argument.....	11
Argument	13
The District Court did not err in determining that the pay- ments involved herein were dividends taxable as ordinary income	13
Conclusion	27
Appendix. Statutes and Regulations involved (see Index thereto)	

INDEX TO APPENDIX

	PAGE
Internal Revenue Code:	
Sec. 21 (26 U. S. C., 1936 Ed., Sec. 21).....	1
Sec. 22 (26 U. S. C., 1946 Ed., Sec. 22).....	1
Sec. 27 (26 U. S. C., 1946 Ed., Sec. 27).....	1
Sec. 115 (26 U. S. C., 1946 Ed., Sec. 115).....	2
Sec. 148 (26 U. S. C., 1946 Ed., Sec. 148).....	6
Treasury Regulations 103:	
Sec. 19.115-1	7
Sec. 19.115-5	8
Sec. 19.148-1	11
Sec. 19.148-2	11

TABLE OF AUTHORITIES CITED

CASES	PAGE
Bazley v. Commissioner, 155 F. 2d 237; aff'd, 331 U. S. 737.....	27
Beattie Inv. Co. v. United States, 101 F. 2d 850.....	17
Beretta v. Commissioner, 141 F. 2d 452; cert. den., 323 U. S. 720	18
Boehm v. Commissioner, 326 U. S. 287.....	13
Burnside Veneer Co. v. Commissioner, 167 F. 2d 214.....	25
Cardillo v. Liberty Mutual Co., 330 U. S. 469.....	13
Commissioner v. Rainier Brewing Co., 166 F. 2d 324.....	13
Crown Willamette Paper Co. v. McLaughlin, 81 F. 2d 365.....	13
Flanagan v. Helvering, 116 F. 2d 937.....	27
Gaytime Frock Co. v. Liberty Mut. Ins. Co., 148 F. 2d 694.....	14
Gossett v. Commissioner, 59 F. 2d 365.....	13
Helvering v. Edison Securities Corp., 78 F. 2d 85.....	13
Helvering v. Gowran, 302 U. S. 238.....	26
Heyman v. Commissioner, 176 F. 2d 389.....	25
Hirsch v. Commissioner, 124 F. 2d 24.....	27
Holmby Corp. v. Commissioner, 83 F. 2d 548.....	18
Jones v. Dawson, 148 F. 2d 87.....	13, 17
LeTulle v. Scofield, 308 U. S. 415; rehear. den., 309 U. S. 694....	26
Mine Hill & Schuylkill Haven R. Co. v. Smith, 184 F. 2d 422....	14
National Grocery Co. v. Commissioner, 111 F. 2d 328.....	13
Raffold Process Corp. v. Commissioner, 153 F. 2d 168.....	14
Schweppe v. Commissioner, 168 F. 2d 284.....	14
Seattle Brewing & Malting Co. v. Commissioner, 166 F. 2d 326..	13
St. Clair Estate Co. v. Commissioner, 9 T. C. 392.....	9, 23
Tennessee Coal, Iron & R. Co. v. Muscoda Local No. 123, etc., 137 F. 2d 176.....	14

	PAGE
Thornton v. Commissioner, 159 F. 2d 578.....	17
Tootle v. Commissioner, 58 F. 2d 576.....	18
Vesper Co. v. Commissioner, 131 F. 2d 200.....	26
Wilcox v. Commissioner, 137 F. 2d 136.....	17, 26, 27

STATUTES

Internal Revenue Code:

Sec. 22 (26 U. S. C., 1946 Ed., Sec. 22)	11, 13
Sec. 115 (26 U. S. C., 1946 Ed., Sec. 115).....	
.....	11, 12, 14, 15, 17, 18, 23, 24, 26
Sec. 148 (26 U. S. C., 1946 Ed., Sec. 148).....	22
Sec. 1291 (28 U. S. C., 1946 Ed., Sec. 1291).....	2
Sec. 1346 (28 U. S. C., 1946 Ed., Sec. 1346).....	2
Sec. 3772 (26 U. S. C., 1946 Ed., Sec. 3772).....	2

No. 12,721

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

L. P. ST. CLAIR and ANNASTATIA ST. CLAIR,

Appellants,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal From the United States District Court for the
Southern District of California.

BRIEF FOR THE UNITED STATES.

Opinion Below.

The opinion of the District Court in the *L. P. St. Clair* case [R. 22-26] is reported in 90 Fed. Supp. 249. The memorandum opinion in the *Annastatia St. Clair* case [R. 48-49] is not reported.

Jurisdiction.

This appeal involves federal income taxes for the calendar years 1939 and 1940. The taxes in dispute are in the amounts of \$1,327.19 and \$1,189.91, respectively, in the case of L. P. St. Clair [R. 7, 12] and \$1,296.13 and \$1,138.49, respectively, in the case of Annastatia St. Clair [R. 35, 39]. The taxes in each case were paid in quarterly installments in 1940 and 1941. [R. 3, 8, 31, 36.] Claims

for refund were filed on July 14, 1943. [R. 165-173, Deft. Exs. A-D.] Each of the claims was rejected by the Commissioner of Internal Revenue by registered letter dated December 23, 1948, pursuant to Section 3772(a)(2) of the Internal Revenue Code. [R. 7, 11, 35, 39.] Thereafter and within the time provided in Section 3772 of the Internal Revenue Code or on May 20, 1949, the taxpayers brought actions in the District Court for recovery of the taxes paid [R. 3-13, 31-40], and the actions were ordered consolidated for trial on March 28, 1950 [R. 21]. Jurisdiction was conferred on the District Court by 28 U. S. C., Section 1346. The judgments were entered on July 31, 1950. [R. 29-30, 51-52.] Within sixty days and on September 22, 1950, a notice of appeal was filed in each action [R. 173, 174] pursuant to the provisions of 28 U. S. C., Section 1291.

Question Presented.

Is the finding of the District Court that distributions of earnings and profits of a corporation in 1939 and 1940 were taxable dividends, rather than distributions in partial liquidation, clearly erroneous?

Statutes and Regulations Involved.

The applicable statutes and regulations are set forth in the Appendix, *infra*.

Statement.

The facts as stipulated [R. 53-66, 158-159] and as found by the District Court [R. 22-26] may be summarized as follows:

The St. Clair Estate Company was organized in 1903 by the St. Clair family consisting of father, mother, three

sons and one daughter. After the death of the father and mother in 1904 all of the 1,200 shares of stock of the corporation were divided equally between the three sons, L. P. St. Clair, E. S. St. Clair, F. C. St. Clair, and the daughter, Cora St. Clair. The three brothers became directors. Cora St. Clair eventually lost her stock through a pledgee's sale and an execution sale and the stock was subsequently acquired by E. S. St. Clair. However, the corporation continued to pay her amounts which aggregated \$80,000 between 1917 and 1928. [R. 53-54.]

Ever since 1910 there had been dissension between Cora and her brothers, which in 1928 resulted in Cora filing suit against them. This suit was settled by agreement, which provided that 300 shares of the corporation's stock should be transferred to a trustee for the benefit of Cora and her son. The agreement also provided that from January 31, 1929, the surplus profits thereafter accumulated should be determined annually as nearly as practicable on February 1 and dividends declared distributing such surplus to the stockholders. Cora's share was to be paid in twelve equal monthly installments. [R. 54-55.]

Prior to 1938 the directors of the company made no formal declaration of dividends and no entry thereof was made on the minute book. However, during each of the years following the execution of the settlement agreement, with few exceptions, Cora's trustee was paid \$500 per month as dividends. During this time the three brothers had accounts on the books of the company designated "Dividend Accounts" to which were credited from time to time amounts payable to them and which were debited with payments made to them from time to time upon their demand. [R. 56.]

On December 22, 1938, Cora filed an action (No. 33,053) in the Superior Court of the State of California in and for the County of Kern against the corporation and her three brothers. In it she accused them of mismanagement and fraud and asked for a dissolution of the corporation and for an accounting in respect to its affairs. She did not question the validity of the dividends shown on the St. Clair Estate Company's books as payable to the brothers but contended that they owed the corporation sums in excess thereof, and upon that basis she asked that the St. Clair Estate Company be restrained from paying any moneys to the brothers as dividends or otherwise pending trial of the action. On the same day the court issued a temporary restraining order forbidding the corporation or any of the brothers from "disposing" of the corporation's assets "excepting in the general and ordinary course of business" and forbidding it from "declaring or paying any dividends" to its shareholders. [R. 56-57, 67-70.] The order was later made permanent pending trial of the action. [R. 58-59.]

On December 23, 1938, the directors of the corporation held a meeting at which they adopted, among others, resolutions declaring that all sums paid Cora's trustee from January 31, 1929, through December 31, 1937, were and constituted dividends for the year in which paid, and further declaring that the corporation's action in crediting and paying to the three brothers equalizing dividends so that the total dividends paid to each stockholder for the period January 31, 1929, through December 31, 1937, would aggregate \$56,000 was ratified and confirmed. They also adopted a resolution authorizing a distribution of \$20 per share, or a total of \$24,000 payable forthwith. The resolutions further authorized the officers to sell securities

held by the corporation for the purpose of providing funds to satisfy the distributions authorized thereby, or to distribute such securities in kind. [R. 57-58, 70-77.]

Before the meeting of the directors held on December 23, 1938, had adjourned, a copy of the court order entered on the preceding day was served, and the brothers, immediately following adjournment, and on December 23, 1938, obtained a modification of the order so as to remove the restraint against the declaration of dividends. However, the restraint on payment continued in full force and effect. The distribution of \$24,000 was recorded on the St. Clair Estate Company's books in December, 1938, by entries debiting dividends declared with that amount and crediting the dividend account of Cora's trustee and each of the three brothers with the amount of \$6,000 with the explanation "to record dividends for the year 1938." [R. 58.]

On the same day, December 23, 1938, the shareholders of the St. Clair Estate Company held a meeting at which it was resolved that the corporation wind up its affairs and voluntarily dissolve, and the officers and directors were authorized and directed to take such steps as might be necessary in that direction. A plan of distribution of the assets was adopted. [R. 149-157.]

On January 10, 1939, Cora, her son and the trustee filed in the Superior Court of California for Kern County a shareholders' petition (Action No. 33,107) for court supervision of the winding up of the affairs of the St. Clair Estate Company, as provided for under the California Civil Code. After hearing was had on the petition an order was filed on April 20, 1939, providing that the corporation's affairs be wound up under the supervision of the court and that no distribution should be made of the

St. Clair Estate Company's assets or property except by order of the court. [R. 59.]

The District Court found [R. 23] that the resolutions of the shareholders adopted at their meeting of December 23, 1938, were stayed in their effect by the institution of proceedings by Cora St. Clair and the injunction issued on December 23, 1938. The court further found [R. 23] that the subsequent institution by the corporation (the court made a clerical error in using the word "corporation," as it was actually Cora who instituted these proceedings also) of an action in the same Superior Court seeking the court's assistance in winding up the affairs of the corporation was of no effect as a liquidation; that the Superior Court in the "dissolution" action could not proceed with any pattern of liquidation of the corpus of the estate until the rights of the shareholders were determined [R. 23].

On April 28, 1939, the court, pursuant to the stipulation of the parties, ordered that the St. Clair Estate Company pay the sum of \$24,000 to its stockholders (\$6,000 each). The stipulation stated that the marketable value of the corporation's assets was \$250,000. [R. 25, 97.] Thereafter, on October 13, 1939, the court construed the distribution authorized in its order of April 28, 1939, to be a distribution from the income of the corporation, rather than from its capital assets. [R. 59, 99-100.] The dividend was paid on May 8, 1939. The stockholders' dividend accounts on the St. Clair Estate Company's books were debited with the amounts paid them and on the stubs of the checks issued for the payment were entered the statement "Account dividend declared December 23, 1938." Each of the brothers in his 1938 return reported as dividends and income received in 1938, the amount of \$6,000

representing his part of the dividend, and paid the tax thereon. Subsequently the Treasury Department refunded to the brothers the tax paid on the amounts so reported. [R. 59-60.]

On December 27, 1939, the directors authorized the distribution of \$23,000 to the shareholders payable forthwith. The purpose of the dividend was stated to be the distribution of the net earnings of the company for 1939, in order to escape penalties to which personal holding companies are subject for failure to distribute their net income. [R. 60, 103.]

Pursuant to the stipulation of the parties in Action No. 33,053 that the restraining order might be so modified, the court, on December 27, 1939, entered its order authorizing and directing the payment by the St. Clair Estate Company to its stockholders in 1939 "amounts up to the net earnings of said corporation for the year 1939." Thereafter on the same day a stipulation of the parties was filed in Action No. 33,107 authorizing the distribution to the shareholders of \$23,000. Later the same day checks for \$5,750 were delivered to each of the four shareholders of the St. Clair Estate Company. In their 1939 income tax returns taxpayers included in income as dividends received in 1939 the sum of \$11,750 distributed to them as hereinabove set forth during the calendar year 1939 consisting of the \$6,000 authorized by the resolutions of December 23, 1938, and the \$5,750 authorized by the resolutions of December 27, 1939. [R. 60-61.]

Pursuant to stipulation of the parties, the Superior Court, in Action No. 33,107, during 1940 entered four orders directing payment by the St. Clair Estate Company in that year of amounts totalling \$26,000. An order entered June 4, 1940, directed the payment of \$6.66 per

share "out of the earnings of 1940." [R. 61, 134-135.] An order entered October 3, 1940, directed the payment of \$4,000 "out of the St. Clair Estate Company income on hand." [R. 61, 136.] An order entered December 11, 1940, directed the payment of \$8.33 per share "out of the earnings of the above corporation for the year 1940 solely." [R. 61, 138.] An order entered December 26, 1940, directed the payment of a dividend of \$3.33 $\frac{1}{3}$ per share "solely out of and from income that has accrued to the said corporation for the calendar year 1940 and that is now available for said purpose." [R. 61-62, 139-140.] The minutes of the meetings of the board of directors held in 1940 authorizing the foregoing distributions state that they were declared because the corporation would "suffer heavy penalties unless distribution is made of its net income for the year 1940" [R. 62, 127, 131], and in order to distribute "further income" to its shareholders [R. 62, 133].

The District Court found [R. 25] that the Superior Court of California for Kern County recognized the binding effect of the injunction by modifying it to the extent of permitting the payments of profits only.

The fair market value of distributions made by the St. Clair Estate Company to the taxpayers as shareholders during 1939 and 1940 did not exceed their basis for computing gain on the stock. [R. 158.]

The four distributions authorized during the year 1940 were paid by the corporation, each of the shareholders receiving as his share \$6,500. In their 1940 federal income tax returns taxpayers included in income and reported as dividends the amount so received. [R. 62.]

The stockholders of the St. Clair Estate Company did not surrender any of their certificates of stock in the corporation, and the corporation did not cancel any certificates or shares of its stock in the years 1939 through 1949. [R. 61, 62, 159.]

Thereafter proceedings involved in Actions Nos. 33,053 (the accounting action) and 33,107 (the winding up action) proceeded simultaneously. The accounting action was terminated adversely to Cora on January 18, 1945. The winding up action was terminated in 1949 [Exhibit T transmitted in its original form]. [R. 62-63.]

The St. Clair Estate Company claimed a dividend paid credit for each of the years 1939 and 1940 in the total amount of the distributions made. Its net income for each of the years was less than the amount of the distributions. Its earned surplus at the close of each of the years was in excess of \$150,000. The Commissioner found a deficiency against the corporation for the years 1937 to 1940. The determination was appealed (*St. Clair Estate Co. v. Commissioner*, 9 T. C. 392). The Government prevailed as to 1937 and 1938 and the taxpayer prevailed as to 1939 and 1940. Both parties appealed, but on November 3, 1948, each of the parties dismissed its appeal. [R. 63-64.]

Thereafter the St. Clair Estate Company filed with the Commissioner a notice of intention to claim a deficiency dividend credit under Section 506 of the Internal Revenue Code for the year 1937, and on June 22, 1948, made a

distribution to its stockholders as provided in Section 506 (c) of the Internal Revenue Code. Thereafter it filed its claim for credit and the claim was allowed in full. [R. 64.]

On February 18, 1949, and within the time permitted by law, the St. Clair Estate Company filed with the Commissioner its notice of intention to claim a deficiency dividend credit for the year 1938. Prior thereto, however, the St. Clair Estate Company, on October 28, 1948, paid the 1938 deficiency found by the Tax Court to be \$8,318.77. Thereafter the corporation filed in the Superior Court of California for Kern County, in Action No. 33,107, a petition for an order distributing assets of the corporation in final liquidation, praying therein that the corporation be permitted to distribute its assets so that the time and distribution thereof would permit the corporation to obtain a deficiency dividend credit which would operate to expunge the 1938 deficiency. Accordingly, on December 30, 1948, the court entered an order conforming with the prayer in the petition. [R. 64-65.]

Final distribution of the remaining assets of the St. Clair Estate Company was made September 29, 1949 [R. 65, 148], and order of final dissolution of the corporation was entered January 12, 1950 [R. 65-66].

On these facts the District Court concluded that the distributions made to stockholders during 1939 and 1940 were dividends taxable at ordinary rates, and that taxpayers are not entitled to recover the taxes sued for for those years. [R. 27-28.]

Summary of Argument.

1. The District Court's finding that the distributions in 1939 and 1940 were ordinary dividends, instead of distributions in liquidation, is correct. As is shown by the corporate resolutions and the court orders approving the payments, the distributions were intended and were paid as distributions of the corporation's earnings, for the purpose of securing dividends paid credits to avoid the personal holding company surtax. Since the corporation had sufficient current and accumulated earnings to cover the distributions, they constitute dividends as defined by Section 115 (a) and (b) of the Internal Revenue Code, and are taxable in full under Section 22 (a) of the Code. It was stipulated that the distributions were not made in cancellation or redemption of the stock, and this fact is fatal to taxpayers' contention that the distributions were partial liquidating distributions, under either Section 115 (i) or (c). Moreover, they were not intended as liquidating distributions.

2. Actually the corporation was not engaged in liquidating during the taxable years, as the District Court correctly found. Although a resolution looking toward liquidation was adopted by the stockholders, this was after the injunction had been served on the corporation preventing it from disposing of its assets and property, and from declaring and paying dividends. Thus, liquidating distributions could not be made and the process of liquidation was stalled by the court until after the rights of the parties were determined. It follows that the dividends later paid

pursuant to court order were not distributions made while the corporation was liquidating, where the litigation was unsettled and the court had not yet authorized liquidation and distribution of the assets.

3. Taxpayers erroneously state that in the corporation's case the Tax Court has previously decided that the distributions in question were distributions in liquidation. The Tax Court merely assumed that they were without so deciding and disposed of the issue as to whether the corporation was entitled to dividends paid credits in the amount of its stipulated net income for 1939 and 1940 on that assumption.

4. Not only do the distributions involved here fail to meet the definition of "complete liquidation" in Section 115 (c) because they were not made in complete cancellation or redemption of the stock, but they also fail to meet the definition for the reason that the liquidation was not completed within the three year period there specified.

5. Even if the distributions are assumed *arguendo* to be distributions in partial liquidation within Section 115 (i) and (c), they still must be taxed as dividends under Section 115 (g). Since the purpose was to distribute earnings to obtain dividends paid credits and since the earnings were sufficient to cover the distributions, the distributions were essentially equivalent to taxable dividends within the meaning of Section 115 (g).

ARGUMENT.

The District Court Did Not Err in Determining That the Payments Involved Herein Were Dividends Taxable as Ordinary Income.

The only question in this case is whether the lower court erred in finding that the distributions of \$47,000 in 1939 and \$26,000 in 1940 by the St. Clair Estate Company to its shareholders were ordinary dividends, taxable in full under Section 22(a) of the Internal Revenue Code (Appendix, *infra*), rather than, as taxpayers contend (Br. 15), "partial distributions in complete liquidation of the corporation." It is the Government's position that the District Court's classification of the distributions as dividends is overwhelmingly supported by the evidence and is plainly correct.

As stated by the trial court [R. 22] and acknowledged by taxpayers (Br. 14), the question of whether payments were ordinary dividends or distributions in liquidation is one of fact (*cf. National Grocery Co. v. Commissioner*, 111 F. 2d 328 (C. A. 9th); *Jones v. Dawson*, 148 F. 2d 87, 90 (C. A. 10th); *Gossett v. Commissioner*, 59 F. 2d 365, 367 (C. A. 4th); *Helvering v. Edison Securities Corp.*, 78 F. 2d 85 (C. A. 4th)), as to which the decision of the trial court is final unless clearly erroneous (*Crown Williamette Paper Co. v. McLaughlin*, 81 F. 2d 365, 368 (C. A. 9th)). Although it is true as taxpayers point out, that the facts upon which the trial court's determination was predicated were entirely stipulated, the judgment of the trial court is not subject to reversal in the absence of clear error. *Boehm v. Commissioner*, 326 U. S. 287, 293; *Cardillo v. Liberty Mutual Co.*, 330 U. S. 469, 478; *Commissioner v. Rainier Brewing Co.*, 166 F. 2d 324 (C. A. 9th); *Seattle Brewing & Malting Co. v. Commissioner*,

166 F. 2d 326 (C. A. 9th); *Schaepppe v. Commissioner*, 168 F. 2d 284 (C. A. 9th); *Raffold Process Corp. v. Commissioner*, 153 F. 2d 168, 171 (C. A. 1st); *Gaytime Frock Co. v. Liberty Mut. Ins. Co.*, 148 F. 2d 694, 696 (C. A. 7th); *Tennessee Coal, Iron & R. Co. v. Muscoda Local No. 123 etc.*, 137 F. 2d 176 (C. A. 5th). The most recent statement of the law in this respect is the *Mine Hill & Schuylkill Haven R. Co. v. Smith*, 184 F. 2d 422 (C. A. 3d), where the court said (p. 426):

* * * the question * * * *is purely one of fact* to be determined in the first instance by the trier of the facts; the circumstance that the facts are stipulated does not make the issue any less factual in nature; the trier of the facts is entitled to draw whatever inferences and conclusions it deems reasonable from such facts; it is immaterial that different conclusions might fairly be drawn from the undisputed or stipulated facts and the appellate court is *limited* to a consideration whether the fact finding was “clearly erroneous” and the decision of the trial court was “in accordance with law” * * *.

At any rate, the facts in the instant case so clearly compel the conclusion reached by the trial court that a precise delimitation of the appellate scope of review is hardly essential.

Section 115(a) of the Code (Appendix, *infra*) defines a dividend as *any* distribution by a corporation to its shareholders out of its earnings or profits accumulated after February 28, 1913, or out of earnings or profits of the taxable year without regard to the amount of the (accumulated) earnings at the time the distribution is made, and Section 115(b) (Appendix, *infra*) establishes a rule that every distribution is made out of earnings or profits

to the extent thereof, and from the most recently accumulated earnings or profits. An exception to this rule is stated in Code Section 115(c) (Appendix, *infra*) which provides that in the case of amounts distributed in partial liquidation, the part of such distribution which is properly chargeable to capital account should not be considered a distribution of earnings or profits.

Section 115(i) of the Code (Appendix, *infra*) defines “amounts distributed in partial liquidation” as, insofar as here material, one of a series of distributions in complete cancellation or redemption of all or a portion of a corporation’s stock. And under Section 115(c) such a distribution is treated as one in part or full payment in exchange for the stock, with only the gain on the exchange subject to tax. Such gain is considered as a short-term capital gain (taxable in full), except in the case of amounts distributed in complete liquidation, and for this purpose “complete liquidation” includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all its stock in accord with a bona fide plan of liquidation under which the transfer of the property is to be completed within a time specified in the plan not in excess of three years from the close of the taxable year during which the first of the series of distributions is made under the plan.

1. In this case the distributions in both 1939 and 1940 have all the characteristics of an ordinary dividend and they clearly were dividends. They were made and authorized as distributions on the stock for the purpose of distributing the earnings and profits of the corporation. Thus the directors on December 23, 1938, voted the payment forthwith of a dividend of \$24,000 on the outstanding stock out of the earned surplus and surplus profits.

[R. 74.] While immediate payment of this dividend was prevented by the restraining order served December 23, 1938, which enjoined the disposition of any of the corporation's assets, including the payment of any dividends [R. 69], the court ordered it paid on April 28, 1939 [R. 97-99], and subsequently on October 13, 1939, construed this order to be a distribution and payment of \$24,000 from the income of the corporation, rather than from its capital assets [R. 99-100]. On December 27, 1939, the directors authorized the payment of a 1939 dividend of \$23,000 on the outstanding stock, the resolution stating that the corporation's net income for 1939 was estimated to be \$23,000 and the corporation wished to distribute the earnings to avoid liability for the personal holding company penalty surtax. [R. 103-104.] An order of the court authorizing payment by the corporation to stockholders in 1939 of amounts up to the net earnings of the corporation for 1939 was entered the same day. [R. 60.] Similarly resolutions were adopted by the directors in 1940, authorizing payment forthwith of dividends of \$8,000, \$4,000, \$10,000 and \$4,000, total \$26,000, for the purpose of distributing the estimated net earnings of the corporation for 1940 [R. 125-128, 136, 129-131, 132-134], and the Superior Court entered orders approving payment of the dividends out of the earnings of 1940 or out of the income on hand [R. 134-135, 136-137, 138-139, 139-140].

The corporation's net income for 1939 actually was \$21,417.48 and for 1940 \$19,107.58, but its accumulated earnings and profits at the close of each year were in

excess of \$150,000. [R. 63.] Consequently, not only were the distributions of \$47,000 in 1939 and \$26,000 in 1940 intended to be ordinary dividends on the outstanding stock, as the corporate resolutions and the court orders show, but also the distributions were plainly dividends as defined by Section 115(a), that is, distributions of the current earnings to the extent thereof and then of the accumulated earnings, as provided in Section 115(b).

The distributions here wholly fail to meet the definition of a distribution in partial liquidation contained in Section 115(i) since they were not one of a series of distributions in complete cancellation or redemption of all or a part of the stock. Neither all nor any part of the stock was cancelled or redeemed by the distributions, as was stipulated. [R. 61, 62.] The par value of the stock was not reduced by the distributions in 1939-1940, the stock was not called in, and no endorsement was made on the stock or on the books indicating a cancellation of any part. Instead each distribution was on the full amount of the outstanding stock, none of which was cancelled or redeemed until many years later (1950). [R. 159.] In these circumstances, the distributions cannot be classed as made in partial liquidation, for the statutory definition contains the criteria which must be met for such classification for purposes of Section 115. *Wilcox v. Commissioner*, 137 F. 2d 136 (C. A. 9th); *Thornton v. Commissioner*, 159 F. 2d 578 (C. A. 7th); *Jones v. Dawson*, 148 F. 2d 87, 90 (C. A. 10th); *Beattie Inv. Co. v. United States*, 101 F. 2d 850 (C. A. 8th). For the reason that the distributions in question were not

made as one of a series in cancellation or redemption of all the stock, they likewise do not fall within the definition of "complete liquidation" in Section 115(c), if that definition is pertinent in this case.¹

Furthermore, an important element in determining whether payments are dividends or distributions in partial liquidation is whether the payment was made with the intention that it be a liquidating distribution or one in the ordinary course of business. *Holmby Corp. v. Commissioner*, 83 F. 2d 548, 549-550 (C. A. 9th); cf. *Beretta v. Commissioner*, 141 F. 2d 452, 454 (C. A. 5th), certiorari denied, 323 U. S. 720; *Tootle v. Commissioner*, 58 F. 2d 576, 580 (C. A. 8th). Here in the taxable years, the St. Clair Estate Company did not distribute any of its property other than its earnings and profits. Instead it continued to hold its properties as before and to collect the income therefrom. That is, it, as a personal holding company, appears to have conducted its ordinary business in the usual way and to have paid the dividends in question as distributions in the ordinary course of business. The intent of the directors was unquestionably, as the resolutions already referred to show, to distribute the earnings to avoid the personal holding company surtax, rather than to make a liquidating distribution.

¹The term "complete liquidation" in Section 115(c) is defined, as stated, for the purpose of the preceding sentence. The preceding sentence reads:

Despite the provisions of section 117, the gain so recognized should be considered as a short-term capital gain, except in the case of amounts distributed in complete liquidation.

If the distributions here are assumed *arguendo* to be distributions in partial liquidation, there would be no gain, it having been stipulated that the taxpayers had not fully recovered their cost bases for the stock through receipt of the distributions in 1939 and 1940. [R. 158.]

That these payments were intended as ordinary dividends rather than distributions in liquidation is confirmed by the fact that they were very small in relation to the value of the corporation's assets, which were stated in the minutes to be about a quarter of a million dollars. [R. 25.] Plainly, if distributions in liquidation had been intended, the directors would have sought to pay out a more substantial part of the corporation's total resources.

2. The District Court found in effect that the corporation was not in the process of liquidation in 1939-1940, because the injunction issued and served on December 23, 1938, stayed all effort to carry out the plan to liquidate until after the rights of Cora and her brothers in the corporation and its assets had been determined. [R. 23.] A brief analysis of the facts confirms the correctness of this conclusion.

The stock of the St. Clair Estate Company was held equally by taxpayer L. P. St. Clair, his two brothers, and a trustee for their sister and her son. [R. 53-55.] On December 22, 1938, Cora filed a suit (Action No. 33,053) against the corporation and the three brothers in which she asked for dissolution of the corporation and for an accounting in respect to its affairs, and on December 22, 1938, an order was signed in that action enjoining the corporation, the officers and her brothers from declaring dividends or in any other way disposing of the corporate assets. [R. 57, 67.] The restraining order was originally temporary, but was later continued in effect pending the trial of the action. [R. 59.] On December 23, 1938, a meeting of the board of directors of the corporation was held at which, among other things, it was resolved: (1) that all sums of money paid to or for the benefit of Cora from January 31, 1929, to and including December 31,

1937, constituted dividends in the year in which paid; (2) that the payment of amounts in the year 1938 to the three brothers to equalize their returns from the corporation with the amounts received by Cora between 1929 and 1937 was ratified; (3) that a dividend aggregating \$24,000 be declared out of the earned surplus and surplus profits of the corporation, payable "forthwith," \$6,000 each to Cora and the three brothers. [R. 57, 73.] Before the meeting of the board of directors had adjourned a copy of the court order entered on the preceding day was served, and the brothers, immediately following the adjournment, and on December 23, 1938 (the same day), obtained a modification of the order to permit the declaration of dividends. [R. 58, 94.] Thereafter, on the same day, the shareholders of the St. Clair Estate Company resolved "to wind up the affairs of the corporation and voluntarily dissolve." [R. 153, Br. 15-16.]

On January 10, 1939, Cora filed a shareholders' petition (Action No. 33,107) for court supervision of the winding up of the affairs of the St. Clair Estate Company, and on April 20, 1939, an order was filed in that action providing that the corporation's affairs be wound up under the supervision of the court and that no distribution should be made of the St. Clair Estate Company's assets or property except by order of the court. [R. 59.] Up to this time the \$24,000 dividend declared at the December 23, 1938, directors' meeting [R. 58, 74] had, of course, not been paid, since the directors were under an injunction against paying any dividends [R. 58, 69].

Since the stipulation of facts [R. 58] and taxpayers' brief (pp. 15-16) show that the accounting proceedings were instituted and the injunction served on the directors before the shareholders voted to liquidate, and since no-

where does the record indicate that liquidation had been previously contemplated, much less authorized, by the corporation, the shareholders' resolution was never of any effect. But even had the shareholders voted to liquidate before the injunction, such liquidation would have been, as stated by the trial court, stayed in its effect pending the outcome of the accounting action. The same is true of the action brought by Cora for court supervision of the "winding up." This proceeding was instituted after the injunction, at a time when all parties concerned knew that no steps, other than the purely technical ones, of filing various papers in the winding up action, could be taken toward liquidation during the pendency of the accounting action, and, in fact, no such steps were taken until after the disposition of that action.

Of great significance is the fact that as far as the record shows the St. Clair Estate Company continued its business exactly as theretofore, that is to say, it held various properties, collected the income from them, and distributed this income to its shareholders. The position of the taxpayers amounts to no more than a contention that, because the stockholders might have desired to liquidate the corporation—a desire which was frustrated by judicial action—distributions of current earnings made subsequent thereto must be treated as liquidating distributions, despite the fact that the corporation did not liquidate its business, but, on the contrary, continued it exactly as in the past. The mere statement of this contention is sufficient to demonstrate its invalidity. It is, of course, of some significance that the assets of the corporation were not distributed in cancellation of the stock until some 10 years later.

Moreover, the officers and directors of the St. Clair Estate Company, of whom taxpayer L. P. St. Clair was

one, apparently did not consider that the corporation was in liquidation, since they failed to comply with the requirements of Section 148 (Appendix, *infra*), which provides that:

Every corporation shall, within thirty days after the adoption by the corporation of a resolution or plan for the dissolution of the corporation or for the liquidation of the whole or any part of its capital stock, render a correct return to the Commissioner, verified under oath, setting forth the terms of such resolution or plan * * *.

The St. Clair Estate Company seems to have been well informed as to the provisions of the Internal Revenue Code, it employed tax counsel [R. 102-103], and its failure to comply with the requirements of Section 148 is strongly indicative of the fact that at the time of the payments no one concerned considered the corporation to be in the process of liquidation.

Taxpayer's assumption (Br. 26) that the court would have dismissed the liquidating action, had it intended to stay liquidation, is entirely without foundation, and contrary to the court's own order in the accounting action, which, without more, had the effect of halting any actual liquidation until final disposition of that suit. While taxpayers are correct in stating (Br. 30-31) that the court could and did lift the restraining order to the extent of allowing the distribution of current earnings, they err in concluding that anything resembling a liquidation could be accomplished as long as the restraining influence of the injunction was in force, and it *was* in force during the taxable years as to actual liquidating distributions.

We submit that the finding of the District Court that the corporation was not in process of liquidation in 1939

and 1940 is clearly correct, and it therefore follows that distributions in those years could not, even in the ordinary sense, be regarded as distributions in liquidation. However, even if the view is taken that the corporation was in liquidation during those years, contrary to the finding, taxpayers are in no better position. As already shown, the distributions do not meet the definition of distributions in liquidation prescribed by Section 115(c) and (i) for tax purposes, since they were not made in redemption or cancellation of stock.

3. Contrary to the taxpayers' assertion (Br. 23), the Tax Court in *St. Clair Estate Co. v. Commissioner*, 9 T. C. 392, did not hold that the 1939 and 1940 distributions were distributions in complete liquidation of the corporation. Its holding was that, as the corporation claimed, it was entitled to dividends paid credits in 1939 and 1940 in the full amount of its stipulated net income for those years. In so holding, the Tax Court said (p. 406):

Since petitioner was technically in liquidation, we shall assume, *arguendo*, that the so-called dividend distributions were distributions in liquidation.

On that assumption, the Tax Court considered whether the distributions were properly chargeable to the current year's earnings (stipulated net income); it concluded that they were and thus allowed the credits. Since the taxpayer made no contention that it was entitled to greater credits, the Tax Court did not consider or decide whether or not the amount of the distributions in excess of the current year's earnings was properly chargeable to accumulated earnings. It has been shown above that these excess distributions were distributions of the accumulated earnings. Far from deciding that the distributions in question ac-

tually were distributions in liquidation, as taxpayers assume the Tax Court did, the Tax Court stated further (p. 409):

* * * it is evident from the entire record before us that petitioner [St. Clair Estate Company], its directors, and the court having supervision over its winding up intended those distributions to be only such distributions as would conform with the economic and fiscal policies encouraged by the personal holding company provisions of the Federal revenue laws * * *.

Thus, the Tax Court's view was entirely consonant with the District Court's views in this case.

It is true that before the Tax Court in the corporation's case the Commissioner took the position that the distributions were in liquidation. But the taxpayers have also reversed their position in this case, since they originally treated the payments involved here as dividends. At any rate, there is no rule which prevents the Commissioner from changing his position as to the legal effect of facts, when he becomes convinced that his first position was not correct. The question here, of course, is whether the District Court was correct in determining that the distributions were ordinary dividends rather than distributions in liquidation, a question which the Tax Court did not decide.

4. Taxpayers endeavor to show that the distributions by their corporation in 1939 and 1940 qualify as distributions in a "complete liquidation" as that term is defined in Section 115(c). Assuming that that statute is pertinent to this case, it is obvious that the distributions in question do not meet the definition, for as shown they were not part of a series in complete cancellation or redemption of all of the stock. Furthermore, the statute requires that the plan

must provide for the liquidation to be completed within a time specified, not exceeding three years from the close of the taxable year during which the first of the series of distributions under the plan is made. Taxpayers contend (Br. 20-21) that because the shareholders resolved to liquidate "forthwith", there was a compliance with the terms of the statute, even though the liquidation was not effected in the three year period, and cite Tax Court cases holding that a plan to liquidate "immediately" suffices, despite the fact that the liquidation took longer than three years. This position of the taxpayers has been adequately answered in *Burnside Veneer Co. v. Commissioner*, 167 F. 2d 214, 218 (C. A. 6th), where the court held that the statute makes completion within the statutory period mandatory. And in *Heyman v. Commissioner*, 176 F. 2d 389 (C. A. 2d), the court, in holding that the time limit was essential to a plan of liquidation said (p. 393):

And, moreover, there was no such time limit as the statute made an essential part of a plan of complete liquidation. The only time fixed for distribution was that it should be after all the liabilities of the company were paid and that they should be paid as soon as possible. Thus, it is apparent that substantial compliance with the statute was lacking and that the Tax Court correctly recognized that.

In any event, since the shareholders did not resolve to liquidate until after the accounting suit had been filed and the injunction served, at which time they were unable to take any effective steps toward liquidation, it is patent that they could not have really intended to carry out a plan of liquidation forthwith.

5. Even if the view were taken that the distributions were liquidating distributions in complete cancellation or

redemption of the stock, nevertheless they would be taxable as dividends under Section 115(g) (Appendix. *infra*). Thus, the District Court's judgment is correct and would have to be affirmed.²

Section 115(g) provides that if a corporation cancels or redeems its stock at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in cancellation of stock, to the extent it represents a distribution of accumulated earnings, shall be treated as a taxable dividend. The 1939 and 1940 distributions here, assuming *arguendo* that they were in partial cancellation of the stock, would be covered by this section. *Cf. Wilcox v. Commissioner*, 137 F. 2d 136, 139 (C. A. 9th). No other conclusion would be possible in view of the fact that the distributions were made for the purpose of distributing the corporation's current earnings, in order to obtain dividends paid credits and to avoid the personal holding company surtax. Thus, they were made at such time and in such manner as to be essentially equivalent to taxable dividends. (*Vesper Co. v. Commissioner*, 131 F. 2d 200 (C. A. 8th).) And since as shown the corporation had earnings for the taxable years and accumulated earnings considerably in excess of the distributions, the distributions represent a distribution of these

²The United States, as respondent on appeal, may urge any ground in support of the judgment below. *Helvering v. Gowran*, 302 U. S. 238; *LeTulle v. Scofield*, 308 U. S. 415, rehearing denied, 309 U. S. 694.

earnings and are taxable as dividends. *Wilcox v. Commissioner, supra*; *Vesper Co. v. Commissioner, supra*, p. 205; *Flanagan v. Helvering*, 116 F. 2d 937, 939-940 (C. A. D. C.); *Hirsch v. Commissioner*, 124 F. 2d 24 (C. A. 9th); *Bazley v. Commissioner*, 155 F. 2d 237 (C. A. 3d), affirmed, 331 U. S. 737.

Conclusion.

The judgment of the District Court should be affirmed.

Respectfully submitted,

THERON LAMAR CAUDLE,
Assistant Attorney General,

ELLIS N. SLACK,
HELEN GOODNER,
VIRGINIA H. ADAMS,

Special Assistants to the Attorney General.

ERNEST A. TOLIN,
United States Attorney.

E. H. MITCHELL,
EDWARD R. McHALE,
Assistant United States Attorneys.

March, 1951.

APPENDIX.

Internal Revenue Code:

SEC. 21. NET INCOME.

(a) *Definition*.—"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

* * * * *

(26 U. S. C. 1946 ed., Sec. 21.)

SEC. 22. GROSS INCOME.

(a) *General Definition*.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest, in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(e) *Distributions by Corporations*.—Distributions by corporations shall be taxable to the shareholders as provided in section 115.

* * * * *

(26 U. S. C. 1946 ed., Sec. 22.)

SEC. 27. CORPORATION DIVIDENDS PAID CREDIT.

* * * * *

(g) *Distributions in Liquidation*.—In the case of amounts distributed in liquidation the part of such

distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the basic surtax credit under this section, be treated as a taxable dividend paid.

* * * * *

(26 U. S. C. 1946 ed., Sec. 27.)

SEC. 115 [As amended by Section 214 (b) of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Section 186 (a) and (b) of the Revenue Act of 1942, c. 619, 56 Stat. 798]. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of Dividend.*—The term “dividend” when used in this chapter (except in section 203 (a) (3) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. Such term also means any distribution to its shareholders, whether in money or in other property, made by a corporation which, under the law applicable to the taxable year in which the distribution is made, is a personal holding company, or which, for the taxable year in respect of which the distribution is made under section 504 (c) or section 506 or a corresponding provision of a prior income tax law, is a personal

holding company under the law applicable to such taxable year.

(b) *Source of Distributions*.—For the purposes of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113. The preceding sentence shall not apply to a distribution which is a dividend within the meaning of the last sentence of subsection (a).

(c) *Distributions in Liquidation*.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. Despite the provisions of section 117, the gain so recognized shall be considered as a short-term capital gain, except in the case of amounts distributed in complete liquidation. For the purpose of the preceding sentence, “complete liquidation” includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under

which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding, from the close of the taxable year during which is made the first of the series of distributions under the plan, (1) three years, if the first of such series of distributions is made in a taxable year beginning after December 31, 1937, or (2) two years, if the first of such series of distributions was made in a taxable year beginning before January 1, 1938. In the case of amounts distributed (whether before January 1, 1939, or on or after such date) in partial liquidation (other than a distribution to which the provisions of subsection (h) of this section are applicable) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. If any distribution in complete liquidation (including any one of a series of distributions made by the corporation in complete cancellation or redemption of all its stock) is made by a foreign corporation which with respect to any taxable year beginning on or before, and ending after, August 26, 1937, was a foreign personal holding company, and with respect to which a United States group (as defined in section 331 (a) (2)) existed after August 26, 1937, and before January 1, 1938, then, despite the foregoing provisions of this subsection, the gain recognized resulting from such distribution shall be considered as a short-term capital gain—

(1) Unless such liquidation is completed before July 1, 1938; or

(2) Unless (if it is established to the satisfaction of the Commissioner by evidence submitted before

July 1, 1938, that due to the laws of the foreign country in which such corporation is incorporated, or for other reason, it is or will be impossible to complete the liquidation of such company before such date) the liquidation is completed on or before such date as the Commissioner may find reasonable, but not later than December 31, 1938.

(d) *Other Distributions from Capital*.—If any distribution made by a corporation to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not a dividend, then the amount of such distribution shall be applied against and reduce the adjusted basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. * * *

* * * * *

(g) *Redemption of Stock*.—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

* * * * *

(i) *Definition of Partial Liquidation*.—As used in this section the term “amounts distributed in partial liquidation” means a distribution by a corporation in complete cancellation or redemption of a part of its

stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

* * * * *

(26 U. S. C. 1946 ed., Sec. 115.)

SEC. 148. INFORMATION BY CORPORATIONS.

* * * * *

(d) *Contemplated Dissolution or Liquidation.*—Every corporation shall, within thirty days after the adoption by the corporation of a resolution or plan for the dissolution of the corporation or for the liquidation of the whole or any part of its capital stock, render a correct return to the Commissioner, verified under oath, setting forth the terms of such resolution or plan and such other information as the Commissioner shall, with the approval of the Secretary, by regulations prescribe.

(e) *Distributions in Liquidation.*—Every corporation shall, when required by the Commissioner, render a correct return, duly verified under oath, of its distributions in liquidation, stating the name and address of each shareholder, the number and class of shares owned by him, and the amount paid to him or, if the distribution is in property other than money, the fair market value (as of the date the distribution is made) of the property distributed to him.

* * * * *

(26 U. S. C. 1946 ed., Sec. 148.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

Sec. 19.115-1 [As amended by T. D. 5228, 1943 Cum. Bull. 183]. *Dividends*.—The term “dividend” for the purpose of chapter 1 (except when used in sections 203 (a) (3) and 207 (c) (1) thereof) comprises any distribution in the ordinary course of business, even though extraordinary in amount, made by a domestic or foreign corporation to its shareholders out of either—

(1) earnings or profits accumulated since February 28, 1913, or

(2) earnings or profits of the taxable year computed without regard to the amount of the earnings or profits (whether of such year or accumulated since February 28, 1913) at the time the distribution was made.

The earnings or profits of the taxable year shall be computed as of the close of such year, without diminution by reason of any distributions made during the taxable year. For the purpose of determining whether a distribution constitutes a dividend, it is unnecessary to ascertain the amount of the earnings and profits accumulated since February 28, 1913, if the earnings and profits of the taxable year are equal to or in excess of the total amount of the distributions made within such year.

The term “dividend” also includes any distribution to shareholders (other than distributions under section 115 (c), relating to distributions in liquidation, section 115 (e), relating to distributions by personal service corporations, and section 115 (f), relating to

stock dividends) made by a corporation which, for the taxable year in which such a distribution is made or for the taxable year in respect of which it is made under section 504 (c), relating to dividends paid within two and one-half months after the close of the taxable year, or section 506, relating to deficiency dividends, or corresponding provisions of a prior income tax law, was under the applicable law a personal holding company. Such a distribution, if made on or after October 21, 1942, will constitute a taxable dividend even if not paid out of accumulated or current earnings or profits. For treatment of any distribution made prior to October 21, 1942, which is a dividend solely by reason of the last sentence of section 115 (a), see section 19.504-3.

A taxable distribution made by a corporation to its shareholders shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands.

* * * * *

Sec. 19.115-5. *Distributions in liquidation.*—(a) *General.*—Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation are to be treated as in part or full payment in exchange for the stock so canceled or redeemed. The gain or loss to a shareholder from a distribution in liquidation is to be determined, as provided in section 111 and section 19.111-1, by comparing the amount of the distribution with the cost or other basis of the stock provided in section 113; but the gain or loss will be recognized only to the extent provided in section 112.

(b) *Complete liquidation*.—In the case of amounts distributed in complete liquidation of a corporation, the amount of the gain or loss so recognized is subject in general to the limitations contained in section 117. For this purpose the term “complete liquidation” includes any one of a series of distributions made by a corporation in complete cancellation or redemption of all of its stock in accordance with a bona fide plan of liquidation and under which the transfer of the property under the liquidation is to be completed within a time specified in the plan, not exceeding, from the close of the taxable year during which is made the first of the series of distributions under the plan, (1) three years if the first of such series of distributions is made in a taxable year beginning after December 31, 1937, or (2) two years, if the first of such series of distributions was made in a taxable year beginning prior to January 1, 1938.

For the purposes of the last sentence of section 115 (c), a liquidation may be completed prior to the actual dissolution of the liquidating corporation but no liquidation is completed until the liquidating corporation and the receiver or trustees in liquidation are finally divested of all the property (both tangible and intangible).

* * * * *

(c) *Partial liquidation*.—In the case of amounts distributed in partial liquidation of a corporation, the amount of the loss recognized is subject to the limitations contained in section 117 but the entire amount of the gain recognized shall be considered as a short-term capital gain despite the provisions of section 117. The term “amounts distributed in partial liquidation”

means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock. A complete cancellation or redemption of a part of the corporate stock may be accomplished, for example, by the complete retirement of all the shares of a particular preference or series, or by taking up all the old shares of a particular preference or series and issuing new shares to replace a portion thereof, or by the complete retirement of any part of the stock, whether or not pro rata among the shareholders.

In the case of amounts distributed in partial liquidation, the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of section 115 (b) for the purpose of determining taxability of subsequent distributions by the corporation. (See sections 19.27(g)-1 and 19.115-11.)

Example: A, an individual whose taxable year is the calendar year, owns 20 shares of participating preferred stock of the Y Corporation, 10 shares of which he purchased in 1924 for \$1,060 and 10 shares of which he purchased in June, 1936, at \$2,000. On May 15, 1939, the corporation in a transaction qualifying as a partial liquidation redeemed the entire issue of preferred stock by paying the holders thereof \$141 per share, A receiving \$2,820 upon the surrender of his 20 shares of such stock. The gain of \$350 on the shares acquired in 1924 should be included in its entirety in A's gross income; but the loss of \$590 on the shares acquired in 1936 should be deducted in computing A's net income to the extent of $66\frac{2}{3}$ percent,

or \$393.33. (See section 117 (b). See also section 117 (c).)

Sec. 19.148-1. *Return of information as to payments of dividends.*—Section 148 provides that every corporation shall, when required by the Commissioner, render a correct return, duly verified under oath, of its payments of dividends, stating the name and address of each shareholder, the number of shares owned by him, and the amount of dividends paid to him. In accordance with that section, returns of information in respect of dividend payments shall be rendered for each calendar year as follows:

* * * * *

Sec. 19.148-2. *Return of information respecting contemplated dissolution or liquidation.*—(a) *Making and filing of returns.*—Within 30 days after the adoption of any resolution or plan for or in respect of the dissolution of a corporation or the liquidation of the whole or any part of its capital stock, the corporation shall file with the Commissioner of Internal Revenue, Washington, D. C., attention of the Income Tax Unit, Records Division, a correct return on Form 966, made under oath or affirmation and containing the information required by paragraph (b) of this section and by such form. A like return shall be filed by the corporation in the case of any amendment of, or supplement to, a resolution or plan for or in respect of the dissolution of the corporation or the liquidation of the whole or any part of its capital stock. A return must be filed under section 148 (d) in respect of a liquidation whether or not any part of the gain or loss to the shareholders upon the liquidation is recognized under the provisions of section 112.

(b) *Contents of return.*—(1) *General.*—There shall be attached to and made a part of the return required by section 148 (d) and paragraph (a) of this section a certified copy of the resolution or plan, together with any amendments thereof or supplements thereto, and such return shall in addition contain the following information:

- (i) The name and address of the corporation;
- (ii) The place and date of incorporation;
- (iii) The date of the adoption of the resolution or plan and the dates of any amendments thereof or supplements thereto; and
- (iv) The collection district in which the last income tax return of the corporation was filed and the taxable year covered thereby.

(2) *Returns in respect of amendments or supplements.*—If a return in respect of any resolution or plan for or in respect of the dissolution of a corporation or the liquidation of the whole or any part of its capital stock has already been filed pursuant to section 148 (d), a return in respect of any amendment thereof or supplement thereto will be deemed sufficient if it gives the date such prior return was filed and contains a duly certified copy of such amendment or supplement and all other information required by this section and by Form 966 which was not given in such prior return. If no return was filed relative to the resolution or plan which is being amended or supplemented, the return relative to the amendment thereof or supplement thereto shall contain a duly certified copy of the resolution or plan which is being amended or supplemented, together with all amendments thereof and supplements thereto, and all other information required by this section and by Form 966.